

MINUTES OF THE REGULAR MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM BOARD

**HELD ON
November 21, 2003
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Karl Polen, Chairman, Arizona State Retirement System Board, called the meeting to order at 8:31 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call, Opening Remarks

Present: Mr. Karl Polen, Chairman
Mr. Norman Miller, Vice Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Dr. Chuck Essigs
Dr. Keith Meredith
Mr. Carl Tenney (Teleconferencing)
Mr. Lawrence Trachtenberg
Mr. Steven Zeman

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the October 17, 2003, Regular Meeting of the ASRS Board

Motion: Mr. Norman Miller moved to approve the minutes of the October 17, 2003 regular meeting.

Mr. Jim Bruner seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

3. Approval of Consent Schedule

Motion: Mr. Norman Miller moved to approve Refunds, Death Benefits, Retirements, System Transfers, and the Applications and Agreements with:

- Yarnell Elementary School District #52 and Crown King Elementary School District #41

Mr. Jim Bruner seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Motion: Mr. Norman Miller moved to approve the following Notices of Rulemaking Docket Openings:

- Practice and Procedure rules
- Modified DROP rules
- Service Purchase Rules

Dr. Chuck Essigs seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding the Appointment of Chief Investment Officer

Mr. Paul Matson, Director, Arizona State Retirement System, discussed the role of Mr. Gary R. Dokes as the Acting Chief Investment Officer and recommended the confirmation of Mr. Dokes as the Chief Investment Officer for the ASRS.

Motion: Mr. Karl Polen moved to approve the confirmation of Mr. Gary R. Dokes as Chief Investment Officer of the ASRS.

Dr. Chuck Essigs seconded the motion.

Mr. Norman Miller and Mr. Jim Bruner both complimented Mr. Dokes for his work and stated their support for him in this position.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding Board Appeal of Ms. Darcy Forst

Mr. Norman Miller pointed out that when it came to “fact finding and evidentiary requirement” in an appeal, it was the policy of the ASRS Board to refer the matter to the Office of Administrative Hearings so that an administrative law judge could make a fact-finding determination and send a recommendation back to the ASRS Board regarding action. Mr. Miller suggested that legal counsel for the Board refer all three appeals on the agenda to the Department of Administrative Hearings for review. Mr. Thomas McClory, Assistant Attorney General for the State of Arizona, said that the appeal by Mr. Louis Sorensen did not require any fact finding and, therefore, did not require review by an administrative law judge.

Motion: Mr. Norman Miller moved that the appeal matters of Ms. Darcy Forst and Ms. Suzanne Koenig be referred to the Office of Administrative Hearings for further review and recommendation.

Mr. Jim Bruner seconded the motion.

Mr. Jim Bruner said that he believed the Board had already directed the ASRS staff to direct appeals to the Office of Administrative Hearings for review. Mr. Bruner said he could not be fair to the appellant because the documents he had were one-sided. Mr. Karl Polen concurred with Mr. Bruner's assessment.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Jim Bruner also suggested that ASRS Staff advise all appellants of the process so that they can adequately prepare and have knowledge of the timing of appeals.

Mr. Thomas McClory indicated to the Board that these were the first appeals he has dealt with since working with the ASRS and said he would take steps to move the appeals to an administrative law judge as quickly as possible.

Mr. Norman Miller suggested that the ASRS reimburse any appellant or person related to the appeal who had any expenses that were "extraordinary or unusual."

6. Presentation, Discussion and Appropriate Action Regarding Board Appeal of Ms. Suzanne Koenig

This agenda item was discussed simultaneously with agenda item #5.

7. Presentation, Discussion and Appropriate Action Regarding Board Appeal of Mr. Louis Sorensen

Mr. Louis Sorensen addressed the Board on his appeal regarding the 13th Check issue. Mr. Sorensen said he received notification that the 13th check would be distributed to system members. Mr. Sorensen discovered that he did not qualify for the 13th check because he retired after June 30, 2001. Mr. Sorensen said he felt that it was an injustice that people who paid into the system but retired after June 30, 2001 were not entitled to the 13th check. Mr. Sorensen asked that the Board reverse the Staff recommendation.

Mr. Charles E. Chittenden, Actuary, Mellon Human Resources and Investor Solutions, said he reviewed Mr. Sorensen's file. Mr. Chittenden indicated that the 13th check is not a lump sum amount, but an annuitized amount. Retired members (who had retired prior to July 1, 2001) received a 13th check, and those who retired after June 30, 2001 received the same amount of dollars, but that money went into their accounts for distribution on a monthly basis with their regular checks during the year as life annuities.

Mr. Karl Polen inquired as to whether Mr. Sorensen was disadvantaged because he continued to work after the cut off period and therefore discriminated against. Mr. Chittenden indicated that the surplus dollars that were paid out in the 13th check for retirees were deposited into the accounts of non-retirees and would be included in their base checks upon distribution.

Ms. Charlotte Borchert asked Mr. Sorensen if he had received any information from the ASRS covering the distribution of excess funds. Mr. Sorensen indicated that he had.

Motion: Mr. Norman Miller moved that the ASRS Board deny Mr. Louis Sorensen's appeal regarding the distribution of the 13th Check.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

8. Presentation, Discussion and Appropriate Action Regarding Open Meeting Law

Mr. Thomas McClory introduced Ms. Jessica Funkhouser, head of the Attorney General's Open Meeting Law Enforcement Team, to give a presentation on Open Meeting Law.

Ms. Funkhouser focused her presentation on the pitfalls that boards fall into on Open Meeting Law. The pitfalls come from actual complaints that have been filed with the Attorney General's Office. Ms. Funkhouser mentioned such things as making sure that the notification of an open meeting is clear, avoidance of skirting the law, and the ramifications of Executive Session.

There was an extended discussion on Executive Session. Mr. Lawrence Trachtenberg asked if you *have* to go into Executive Session per the state statute. Ms. Funkhouser said that you do not *have* to go into Executive Session, but you *may* want to depending on the subject matter. Thomas McClory interjected that if the Board is going to examine confidential documents (medical records, disclosure of documents protected by state law, RFPs), they should go into Executive Session.

Mr. Jim Bruner inquired about dealing with personnel issues. Ms. Funkhouser stated that if there are issues that may jeopardize someone's privacy rights, it would be a good idea to go into Executive Session. She said, however, that a state employee has the right to have their personnel issues discussed in a public meeting, thus prohibiting the Board from taking up the issue in Executive Session, but they do not have the right to attend an Executive Session where their issues are being discussed.

Dr. Chuck Essigs inquired as to the guidelines regarding the "Call to the Public." Ms. Funkhouser indicated that when a member of the public addresses the Board during the "call to the Public," there are only three responses that are allowed: a response to criticism of the Board or a Board member, a recommendation to the staff, for follow up regarding the comment, or a recommendation that the issue be placed on a future agenda. A "Call to the Public" is not required by law to be on the agenda.

Ms. Funkhouser indicated there is a new provision that allows "current events" to be briefly mentioned as long as there is an agenda item stipulating that current events will be discussed (although the exact events should not be spelled out). This is meant to handle last minute informational items that may have happened since the publication of the agenda. There should not be, however, a discussion on the current events brought up by a Board member.

Mr. Carl Tenney asked under what rules may a state employee attend an Executive Session. Ms. Funkhouser indicated that a state employee may attend if his/her attendance is necessary for conducting business. Thomas McClory cited the state statute that said that a state employee may ask that his/her personnel issue not be discussed in Executive Session but that it be discussed in a public session. This law trumps the Executive Session law.

Ms. Charlotte Borchert asked if during litigation, a course of direction for legal counsel must be made public. Ms. Funkhouser stated that explicit direction to legal counsel can be made in Executive Session, but once the Board returns to the public forum, they must state what direction they have given legal counsel.

Ms. Funkhouser pointed out that if a mistake is made vis-à-vis the Open Meeting Law, it can be ratified within 30 days of the mistake.

Mr. Jim Bruner inquired about a quorum of Board members attending a social function. Ms. Funkhouser suggested that if more than two Board members are going to be attending a social function, it would probably be a good idea for the Board to post a "courtesy agenda" that states that a quorum of the Board may be present but that no business will be discussed. Also, the members of the Board should not huddle together at a social function. If there is any concern, Ms. Funkhouser suggested a witness be available to verify that no Board business was discussed. This would apply to the full Board and any committees.

Mr. Steven Zeman inquired as to the penalties for violating the Open Meeting Law. The penalty is a \$500 fine (not to be paid with public funds), removal from office, and payment of court costs and attorney's fees.

Ms. Charlotte Borchert stated that she and other Board members are often at numerous non-Board events as a function of their background. She expressed concern at whether even talking to other Board members at these events violated the Open Meeting Law. Ms. Funkhouser indicated that as long as Board members were not talking about Board business, there should be no problems, but she also suggested that Board members be mindful of public perception.

9. Presentation, Discussion and Appropriate Action Regarding the following:

- A. Five-Year Experience Study and Possible New Assumptions**
- B. Actuarial Valuation of the ASRS Plan and LTD for the Period Ending June 30, 2003**
- C. Actuarial Valuation for the System for the Period Ending June 30, 2003**

Mr. Charles E. Chittenden and Ms. Eva Young gave a presentation on the Five-Year Experience Study that began in 1997 and ended in 2002. Mr. Chittenden mentioned the various assumptions including demographics, economics, and service purchase.

Mr. Norman Miller asked if the reason an older person purchasing service would pay more is because the investment system has less time to use the money put into the system. Ms. Young indicated that Mr. Miller was correct, and also because the older members retire quicker. Dr. Chuck Essigs asked if Mr. Chittenden and Ms. Young would recommend that the service purchase program be re-examined to make sure that service purchase would be equitable to all persons who paid into the system. Mr. Chittenden stated that a project is underway to look at the

service purchase issue regarding equity. Mr. Norman Miller suggested that service purchase be handled on a sliding scale based on age and mortality of the person. Mr. Karl Polen asked if adopting the experience study will change the service purchase program. Mr. Chittenden indicated that it would not.

Other issues under review for the study were the health insurance supplements, the modified DROP, permanent benefit increases, the ability to rescind choice of pension form, and the delay in implementing new contribution rates.

Mr. Norman Miller asked why the ability to rescind the choice of pension form was not included in the assumptions made by Mr. Chittenden. Mr. Chittenden indicated that he had no factual data, only anecdotal. Mr. Miller suggested that such data might be beneficial. Ms. Charlotte Borchert asked Mr. Paul Matson if he could discover what staff is telling members about the ability to change their pension form. Mr. Matson said he would.

Mr. Chittenden talked about the setting of the member contribution rate. The rate itself was set in 2002 for implementation in 2003 to 2005. That rate, however, does not take into account the losses that are accumulated between the time the rate is set and the time it is implemented. Dr. Chuck Essigs asked if the rate does not also take into account the gains that are accumulated in a good year. Mr. Chittenden indicated that gains or losses are both not considered, due to the fact that the rate is set every two years. Dr. Essigs asked if the two-year cycle could be changed without legislation. Mr. Chittenden indicated that they could not.

Mr. Chittenden and Ms. Young discussed the various effects on the rates that may impact the assumption recommendation including retirement, mortality, and disability. Additionally, there will be new impacts on service purchase assumptions.

Motion: Mr. Norman Miller moved that the Five-Year Study and the New Assumptions be accepted as presented.

Dr. Chuck Essigs seconded the motion.

Mr. Norman Miller asked if by accepting these assumptions, the Board was being locked into the assumptions themselves or are they going to be used for further study. Mr. Chittenden said the evaluations had been prepared for 2003 on the old and new assumptions. Mr. Richard Stephenson, Deputy Director, External Affairs, pointed out that any changes in assumptions by the Board must be done through the rule process. Mr. Miller asked if the motion should not direct the Board to make appropriate rule changes. Discussion ensued regarding how the motion should be developed to incorporate the rule change. Ms. Charlotte Borchert inquired as to whether accepting these assumptions would affect the 13th Check issue. Mr. Chittenden said that the 13th Check issue would be handled after the acceptance of the actuarial tables. Mr. Miller suggested that staff be directed to develop a motion on how to handle the acceptance of the Five-Year Study and the new assumptions including the issues surrounding rule making. Mr. Karl Polen directed staff to do so.

At this point, the agenda item was postponed and Mr. Polen stated they would return to the issue later in the agenda after staff had made a recommendation on the motion.

10. Presentation, Discussion and Appropriate Action Regarding Cramer, Rosenthal, McGlynn (CRM) and Strong Capital Management

Gary R. Dokes gave a brief introduction of the Investment Management Division's (IMD) Investment Manager Oversight Program. Mr. Dan Kapanak, Investment Research Analyst, said that the ASRS has about \$1 billion in the mid-cap asset class, but currently has no active value exposure. Though selected 14 months ago as an active Mid-Cap value manager, this manager was not funded given significant personnel changes which occurred soon thereafter. A decision was made to temporarily manage these assets in-house.

As the result of an on-going monitoring of CRM, IMD is now recommending that CRM be retained as an active Mid-Cap manager and be funded with approximately \$70 million.

Motion: Mr. Norman Miller moved that CRM be retained and funded as a U.S. Equity Mid Cap manager with a portfolio of approximately \$70 million.

Dr. Chuck Essigs seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Kapanak discussed the removal of Strong Capital Management as a backup manager for the Small Cap growth and value managers. He cited personnel departures and Strong Capital's mutual fund trading activities which are now under investigation. He recommended that they be removed.

Motion: Mr. Norman Miller moved that Strong Capital Management be removed and terminated as the backup manager for Small Cap growth and value manager for ASRS.

Ms. Charlotte Borchert seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Terry Dennison addressed the Board regarding the mutual fund trading practices that are now under investigation. There is approximately \$7 trillion invested in the mutual fund industry. The Attorneys General of New York and New Hampshire as well as the Securities and Exchange Commission are now investigating illegal conduct within the industry which allowed individuals to buy and sell funds after market hours. While this mostly involves mutual funds, the companies under investigation also manage other accounts.

Mr. Karl Polen asked if any of the current ASRS managers are implicated in the scandal. Mr. Dennison said that there are various levels of implication. No ASRS managers have been filed suit against, but some are being investigated. Frontier is being investigated in the latest round of subpoenas. Mr. Polen asked about the status of Putnam. Mr. Dennison said Putnam is not a manager for ASRS nor have they been proposed as a manager. Mr. Polen asked about the relationship among Putnam, Marsh and Mercer. Mr. Dennison confirmed that Mercer and Putnam are sister companies owned by a common parent, Marsh. He indicated that his

judgments about Putnam are independent and that he receives no direction or encouragement from Marsh about how to give advice to his clients with respect to Putnam. In fact, he has not recommended Putnam to ASRS, and for those of his clients who have invested in Putnam, he recently has advised them to divest their holdings.

Mr. Karl Polen stated that due to the fact the Director of the ASRS was not in the Board Room, the Board would skip the Director's Report and return to it after dealing with other issues on the agenda.

11. Presentation, Discussion and Appropriate Action Regarding Real Estate Consultant Search

Mr. Gary R. Dokes addressed the Board regarding the recommendation of a real estate consultant to assist in the development, implementation and future management of the real estate program. After consideration of RFPs, on-site consultant due diligence visits and interviews, the Investment Review Committee has recommended that Courtland Partners be accepted as the ASRS Real Estate Consultant.

Motion: Mr. Jim Bruner moved the Board concur with the recommendation of the Investment Review Committee and hire Courtland Partners as the ASRS Real Estate Consultant.

Mr. Norman Miller seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

12. Presentation, Discussion and Appropriate Action Regarding Domestic Tactical Asset Allocation (TAA)

Mr. Gary R. Dokes addressed the Board regarding the ASRS Domestic Tactical Asset Allocation (TAA) and to provide recommendations on whether changes to the existing TAA mandate were warranted. Mr. Dokes gave a brief overview of how the TAA has worked at the ASRS. Mr. Michael Viteri described the history of the TAA.

Motion: Mr. Jim Bruner moved to approve the Global Tactical Asset Allocation mandate and contract award to Goldman Sachs Asset Management and Bridgewater Associates as GTAA managers with funding to be complete by December 31, 2003, with a portfolio size of approximately \$1.8 billion divided equally between the two managers; and to recommend to approve the TAL and Morgan Stanley as back-up GTAA managers; and to defund the Tactical Asset mandate managed by Barclays Global Investors.

Ms. Charlotte Borchert seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

At this point, Mr. Karl Polen returned to agenda item 9 A – the Five-Year Experience Study and Possible New Assumptions

13. Presentation, Discussion and Appropriate Action Regarding the following:

- A. Five-Year Experience Study and Possible New Assumptions**
- B. Actuarial Valuation of the ASRS Plan and LTD for the Period Ending June 30, 2003**
- C. Actuarial Valuation for the System for the Period Ending June 30, 2003**

Mr. Norman Miller formally withdrew the motion he made under agenda item 9 A and replaced it with a new motion.

Motion: Mr. Norman Miller moved the Board accept the Five-Year Experience Study and the actuary's recommended assumptions as presented and direct the staff to initiate any appropriate rule making activity.

Mr. Lawrence Trachtenberg seconded the motion.

Mr. Karl Polen suggested that in the course of rule making, there be a rule that does not include specific numbers. He stated that having a year-long rule making process can hamper the acceptance of the conclusions of the actuary.

By a vote of 9 in favor, 0 opposed, 0 abstentions and 0 excused, the motion was approved.

Mr. Charles E. Chittenden made a presentation on the actuarial valuation of the plan as of June 30, 2003. Because it is an odd numbered year, the valuation does not determine the contribution rate, but does include the normal cost rate. Mr. Chittenden and Ms. Eva Young discussed the increase in the number of active members and retired members, the active payroll, the average salary and average benefit, the market and actuarial values of assets, the estimated yields on assets [401(a) only], the contributions vs. benefits and refunds, the external cash flow as a percentage of market value, the unfunded actuarial accrued liabilities, and the GASB #25 funded ratio. Also discussed was the various aspects of the contribution rate. Mr. Norman Miller asked Mr. Chittenden to develop a contribution rate chart dating back to the 1970s for legislative purchases. Mr. Chittenden indicated that there will be no new addition to the PBI reserves. Ms. Young touched on the changes in the LTD program.

Motion: Mr. Norman Miller moved to accept as presented the actuarial valuation of the ASRS plan and the LTD for the period ending June 30, 2003, including the new assumptions.

Ms. Charlotte Borchert seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Charles E. Chittenden and Ms. Eva Young made a presentation on the actuarial valuation of the System as of June 30, 2003. Presented was census data on non-retired members, retirees, liabilities, and the status of the plan before any adjustments. Mr. Chittenden recommended that the ASRS not adjust any System benefits this year upwards or downwards (e.g. paying 13th

checks equal to last year's checks), and maintaining all benefits and balances at current levels. he also recommended updating the morality table as of July 1, 2004 to be consistent with the Plan's assumption.

Motion: Mr. Norman Miller moved to accept as presented with assumptions the actuarial valuation of the ASRS System for the period ending June 30, 2003.

Dr. Chuck Essigs seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

At this point, Mr. Karl Polen return to the Director's Report for consideration.

14. Director's Report

Mr. Paul Matson said most items had been discussed but deferred to Mr. Norman Miller for any input on legislative matters. Mr. Miller indicated that he had not received any legislative proposals, but that staff was working on some for legislative action.

15. Request for Agenda Items

None.

16. Call to the Public

Mr. Robert B. Morehouse, President, Senior Citizens Council of Maricopa County, asked that the Permanent Benefit Increase (PBI) be renamed the Moiney Jamison Benefit Increase in respect to Ms. Jamison who worked hard to get the PBI passed. Ms. Jamison recently passed away.

Mr. Robert Letson inquired as to the cost of the service purchase for the various classifications of members (i.e. the number of years they have worked). Mr. Letson expressed concern at how the service purchase amount is determined. He stated he believes that members are not treated equally and equitably and asked for the Board to look into making the system fairer. He also said he would like to see the 401(a), the 401(h) and the LTD figures be broken out more when contribution rates are listed.

Dr. Bev. Cuthbertson asked for information on the effects of delinquency on the ASRS. She inquired as to the rules and regulations regarding how charter schools will be dealt with if they go out of business. Specifically, she asked: 1) if members have money in the system, what happens to their money if an employer is delinquent?; 2) what is the past collection rate for the ASRS (rate of return and how much collection efforts cost the ASRS)?; and 3) how has the delinquent accounts affected the ASRS in terms of liability? Dr. Cuthbertson also asked if the health plan was part of the actuarial accounting. Mr. Karl Polen directed staff to provide the answers for Dr. Cuthbertson. Mr. Jim Bruner asked that the staff copy the Board members on the answers.

17. The next ASRS Board meeting is scheduled for Friday, December 19, 2003, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona.

18. Adjournment of the ASRS Board.

Mr. Karl Polen, Chairman, adjourned the November 21, 2003, meeting of the ASRS Board at 11:20 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Zachary Kucera, Secretary

Date

Paul Matson, Director

Date